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IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 751

MUTUAL SHOE COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioner, Mutual Shoe Company, by its undersigned attorney, respectfully prays for a writ of certiorari to The United States Court of Appeals for the First Circuit in the foregoing cause.

OPINION BELOW

The opinion of the United States Court of Appeals for the First Circuit was rendered on November 9, 1956 (R-A25-A33) and remains unreported as of this date. Said opinion is contained herein in the Record pages A-25 to A-33.

JURISDICTION

The Judgment of the First Circuit sought to be reviewed was entered on November 9, 1956 (R. A-34).

Jurisdiction is conferred upon the Supreme Court of the United States to review this cause by Sections 1254(1) and of the Judicial Code (Title 28, U.S.C.A.) as enacted June 25, 1948; and, the petition is timely within the purview of Section 2101(c) of the Judicial Code (Title 28, U.S.C.A.)

QUESTION PRESENTED

1. Is the amount of normal tax net income—correctly determined according to statute—of a corporation subject to income tax under the Internal Revenue Code of 1939 as amended by the Revenue Act of 1942, subject to change upon such corporation applying for and receiving partial relief from Excess Profits Tax pursuant to Section 722 of said code; or, does the subsequent grant of partial relief from Excess Profits Tax lack retroactivity.

The Tax Court of the United States and the Court of Appeals for the First Circuit held it was retroactive and did change the amount of normal tax net income.

We maintain it is not retroactive and does not change the amount of normal tax net income.

STATUTES INVOLVED

The statutes involved are set forth in verbatim in Appendix A hereof. They are:

Internal Revenue Code of 1939 as amended by the Revenue Act of 1942: Sections 13, 15, 26, 710, 711, 712, 713, 714, 722, 728, 729.

Treasury Regulations 111, Section 29, 26-4 and Regulations 112, Section 35, 722-2.

STATEMENT OF THE CASE

The petitioner is a corporation organized under the laws of the State of Massachusetts; and filed its income tax returns, excess profits tax returns and declared value excess profits tax returns for the years here involved, that is for the fiscal years ending on May 31, 1943, 1944, and 1945 with the Collector of Internal Revenue for the District of Massachusetts at Boston, Massachusetts.

The petitioner in preparing its excess profits tax return determined it Excess Profits Credit on the Invested Capital Method.

Subsequently, the petitioner filed claims for relief from excess profits taxes, which claims were allowed in part, such allowance being based upon a constructive average base period net income of $22,360.00. There is no dispute about the relief allowed to the petitioner under section 722 of the Internal Revenue Code of 1939 as Amended by the Revenue Act of 1942.

Upon granting the aforesaid partial relief from excess profits tax under Section 722, the Commissioner asserted additional income taxes for each of the three years, as follows:

fiscal year ending May 31, 1943 in the amount of	$2,008.52
fiscal year ending May 31, 1944 in the amount of	$1,781.23
fiscal year ending May 31, 1945 in the amount of	$1,535.90
a total for the three years of	$5,325.65

on the theory that the granting of relief, freeing a part of the earnings from excess profits tax, correspondingly increased the amount of earnings subject to the income tax.

We find no provision of law authorizing the increase of earnings subject to income tax, upon the allowance of relief from part of the excess profits tax; and, the Commissioner disagreeing, under date of April 10, 1951 issued the statutory notices of deficiency in the aforesaid amounts.

The petitioner thereupon filed a petition with The Tax Court of the United States pursuant to jurisdiction conferred by Section 272 of the Internal Revenue Code of 1939; and that Court, on December 14, 1955, promulgated its opinion upholding the Commissioner. Decision was entered on December 16, 1955.

The petitioner thereupon filed an appeal with the United States Court of Appeals for the First Circuit and that Court affirmed the decision of the Tax Court on November 9, 1956.

This is a case of first impression. The issue here raised by the petitioner has not been passed upon by any Court other than in this case. The Tax Court and the Appellate Court, like ourselves, were unable to find any provision of law in support of their position; however, both relied upon the broad principle that the Congress intended to divide income into two parts—part subject to the excess profits tax, and the

balance subject to the income tax. That broad principle is correct—but here Congress made an exception. It considered this broad principle here; but, deliberately rejected it by deleting section 722 corporations from those to which a special rule was applied, and left situations such as this to have the income tax determined without regard to relief. The Courts below, contrary to the rationale of *United States* v. *Koppers Company,* 348 U.S. 254 have given relief retroactive effect.

ARGUMENT

The issue here raised is one of law, and it is a case of first impression. It is a federal question of federal tax law not heretofore determined by this Court; and appears to be in conflict with the rationale of the *United States* v. *Koppers Company, Inc.* 348 U.S. 254, decided January 31, 1955.

It is a question that is current—a great number of cases still pending in the office of the Commissioner of Internal Revenue and The Tax Court of the United States involving some millions of dollars will be affected by the outcome of this case. Therefore certiorari should issue so that the question may be set at rest.

The question involves the income tax of a corporation during the years that the excess profits tax was in effect—it does not involve the excess profits tax. It affects the income tax of corporations who sought and were granted relief from a discriminatory excess profits tax during the years 1942 to 1945. Where relief from a discriminatory excess profits tax was procured, the Commissioner concluded that to the ex-

tent that income was relieved of excess profits tax it was to be subjected to income tax.

Neither of the Courts below were able to point to any statutory provision in support of the Commissioner's action; but, nevertheless, concluded that such was the intent of Congress, despite the rejection of such principle by the Conference Committee of the Congress in reconciling the House and Senate versions of the Revenue Act of 1942.

The issue arises in the following manner:

Under the Revenue Act of 1942 corporations were required to file an income tax return and an excess profits tax return and compute their tax in the standard way without recourse to any relief. The tax so computed was required to be paid.

In substance, the income was divided into two parts—one part subject to excess profits tax and the other subject to income tax. The taxpayer, if he considered his excess profits tax excessive and discriminatory was privileged to file a claim for relief from excess profits tax in accordance with Section 722 of the Internal Revenue Code.

Thereupon the claim was processed, negotiations conducted and, in cases where this issue arises, the taxpayer was granted relief by refund of part or all of his excess profits tax. The mechanics to accomplish this was the substitution for the base period net income or the credit on invested capital, of a constructive average base period net income for excess profits tax purposes only (Section 722, IRC)

The Commissioner, however, despite the absence of any section of law, upon granting such relief from

excess profits tax determined that the amount so released from excess profits tax was subject to income tax, and years later—here six years later—retroactively imposed an additional income tax. The following example will illustrate the issue.

	Petitioner	Respondent
Adjusted Net Income	$84,	$84,
50% of Interest on Borrowed Capital	2,	2,
Excess Profits Net Income	86,	86,
Less:		
Specific Exemption	5,	5,
* Excess Profits Credit based on Invested Capital	19,	0,
** Constructive Average Based Period Net Income pursuant to Section 722		22,
Total Deduction	24,	27,
Adjusted Excess Profits Net Income	62,	
Balance:		59,
Adjusted Net Income as above	$84,	$84,
Income subject to excess profits tax as above	62,	59,
Normal Tax Net Income	$22,	$25,

The deficiency here involved results from the larger figure determined by the Respondent's method of computation. It will be noted that the change results from the substitution of the Constructive Average Base Period Net Income, marked ** above for the Excess Profits Credit Based on Invested Capital, marked * above.

In the *United States* v. *Koppers Company, Inc.*, 348 U.S. 254 the Commissioner on the subject of interest took a contrary position and was upheld by this Court.

There (p. 261) this Court said:

> "The Commissioner, on the other hand, contends that the determination under § 722 is not retroactive but is a current abatement effective when made."

Here we likewise claim that the adjustment is not retroactive.

More directly in point is the following analysis made by this Court in the *Koppers* case. It said at pages 263-4:

> "The interest here in controversy was due under § 292(a) from March 15, 1941, until paid. Accordingly, to obtain a refund of it, the taxpayer must sustain the proposition that the tax relief granted under § 722 is necessarily retroactive, extinguishing the deficiency as of the original due date of the tax and thus eliminating the interest charges for the corresponding period. To that end, the taxpayer emphasizes the statement in § 722(a) that, as a condition of securing the application of § 722, a taxpayer must establish that the usual procedure 'results in an excessive and discriminatory tax' and also must establish 'what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income.' Once the taxpayer has done that, 'the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter.' Standing alone, this directive language is elastic. It can be read consistently either with the interpretation that the new computation replaces and abates the old one currently, when the new one is determined and assessed, or that it retroactively replaces the old tax from its original due date. It leaves the issue open for disposition by the effect

of other clauses relating more specifically to the issue. For the reasons hereinafter stated, we read it looking forward, rather than backward."

Applying here the same rule, that is the effect of other clauses relating more specifically to the issue, we must again look forward rather than backward.

Section 26(e) controls the credit to be allowed. It includes four exceptions, and Section 722 cases is not included as an exception. In the House bill, Section 722 cases were included as one of the exceptions; and it was eliminated by the Senate. The Finance Committee in its report No. 1631 to the Senate states: (Cum. Bul. 1942-2, p. 556)

> "Corporations reconstructing average base period net income under section 722 have been removed from this special category and, by reason of the amendments made to section 722 by section 221 of your committee bill, will come under the general rule making the credit under section 26(e) the amount of adjusted excess profits net income."

Later the Conference Committee made its report on October 19, 1942. In its Report No. 2586 (2nd Sess. 77th Congress) it states (Cum. Bul. 1942-2, p. 702):

> "Amendment No. 14: This amendment changes the House provision with respect to the credit of corporations in computing normal tax and surtax for income subject to excess profits tax. Under the House bill, the general rule is that a corporation subject to excess profits tax shall be entitled to a credit in an amount equal to its adjusted excess profits net income. Certain exceptional situations are set forth in which the amount of credit shall be the amount of which the excess profits tax imposed under the particular section making the exception is 90 per cent. The House

bill includes within this exception the cases of corporations computing excess profits tax under sections 721 and 726. The Senate amendment eliminates from the exception provided in the House bill the case of a corporation computing its excess profits tax under section 722 and adds to the exception corporations computing excess profits tax under sections 731 and 736(b)."

The legislative record, therefore, fully supports the position of the petitioner. Congress, in all its wisdom, after full consideration of the subject, concluded that the "adjusted excess-profit net income" credit for corporations procuring relief under section 722, should be the "adjusted excess-profits net income" allowed to corporations not the beneficiaries of 722 Relief. The House first thought otherwise, the Senate eliminated the restriction and the House receded from its position.

CONCLUSION

We therefore urge the Court to grant certiorari. This is a question of great importance in the administration of the tax laws that has not been decided by this Court, but should be, because, what this Court has said in *United States* v. *Koppers Company, Inc.* 348 U.S. 254 clearly sustains our claim that the Court below decided the question wrong.

WHEREFORE, your petitioner prays that a writ of certiorari issue to the United States Court of Appeals for the First Circuit, commanding that Court to certify and send to this Court on a day to be determined a full and complete transcript of the record of all the proceedings of such Court of Appeals had in this cause, to the end that the proceedings and decision

therein may be reviewed and determined by this Court; that the judgment of the Court of Appeals may be reversed; and that the petitioner be granted such other and further relief as may seem proper.

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